DOW THEORY LETTERS INC.

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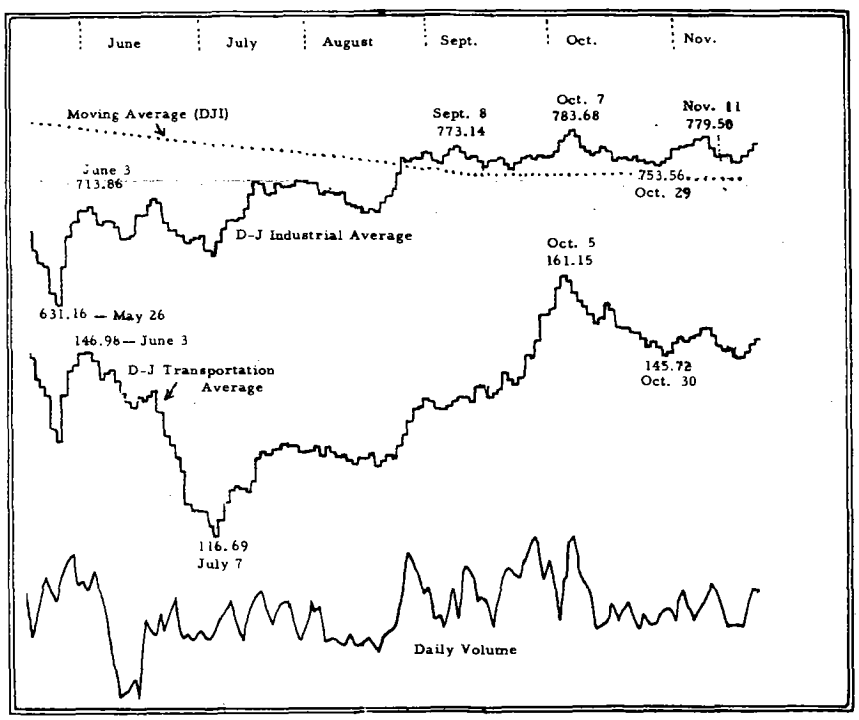
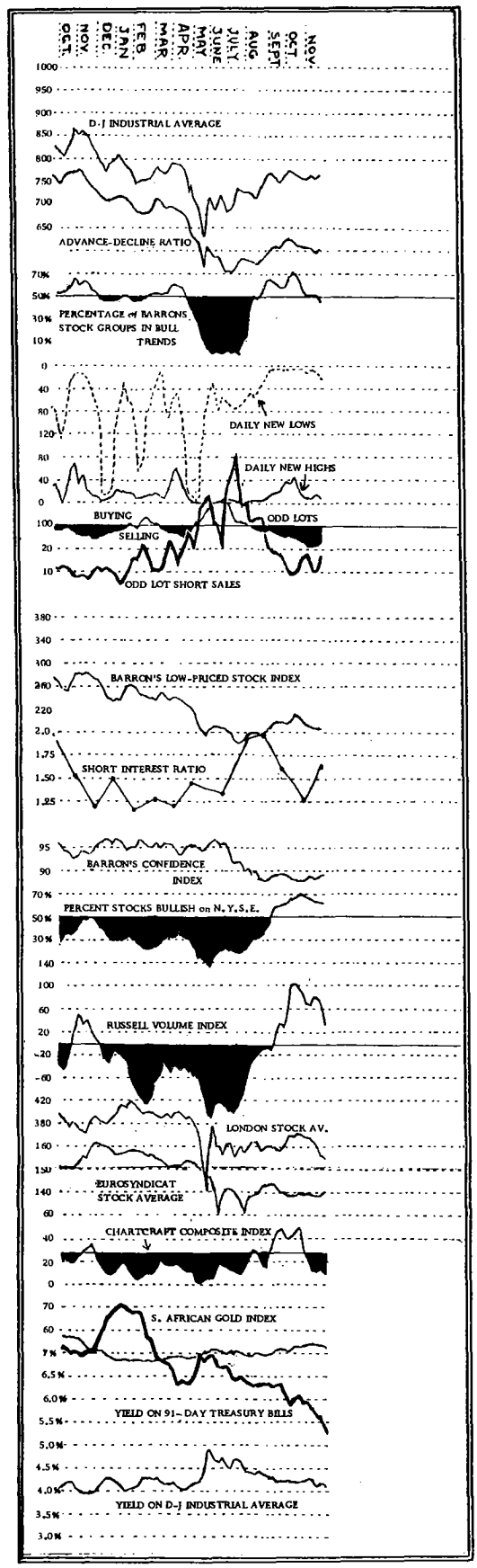
THE MARKET AND THE ECONOMY: From many reports that arrive here, I gather that our Administration is panicking. One finger on the panic button could be the report which economist Pierre Rinfret sent to the White House in which he projected a 10% unemployment rate in 1972 if the Administration continues to follow its current "game plan". Another finger might be the election results, which could hardly have been a source of joy to Mr. Nixon and Mr. Agnew. At any rate, the Defense Department budget requests have been given a big boost (remember the promised reductions?), the U.S. has suddenly begun bombing N. Vietnam again, the discount rate has been reduced (with another reduction probably on the way), and the Fed is attempting to pump up the money supply again.

The baffled and frightened consumer may be the key to business over the coming year. But if there is anything going on now which is calculated to lift consumer confidence in the economy or the Government, I fail to see it. The Average American sees prices running up wildly, a confused Administration which indulges in endless economic double-talk, a dollar which is rapidly losing its value, massive wage boosts in the face of vicious foreign competition, a move towards tariff barriers, sinking corporate profits, and day-to-day bills and expenses which the consumer is finding it increasingly difficult to pay.

Thus I would say that the general picture at this time is far worse than it was in February, 1966, when the first bear sweep started — and worse than late-1968, when the second massive bear swing began. I feel events are building up slowly in favor of the next major bear movement, and this could occur towards late-1970 or more probably during 1971. Meanwhile, there could be a good deal of deceptive and confusing action on the part of the stock market. A year from now, I believe, the current series of rallies and declines will be all but forgotten as prices probe much lower levels, and as the third sweep of the bear market is operating in full force.





 I have been reading quite a bit in other Advisory reports about the "apocalyptic" Dow Theorists, and I know that those words are intended for me and my friend George Schaefer of Indianapolis. I know it because we are often referred to by name and because nobody else is writing the way we are. The dictionary states that "apocalyptic" has to do with "prophetic revelation". Now I don't pretend to have any power of prophetic revelation, but I do follow Dow's Theory, which among other things, is a Theory based on case histories and a knowledge of man's inherent nature.

Charles H. Dow noted that human psychology (at least in the economic sphere) swings from one extreme to the other, from abject pessimism to mindless optimism. Those broad swings in human nature are always reflected in the movements of the stock market. A bull market peak reflects and discounts the very best that can be seen ahead by the great "conscious and unconscious" of the market. Once the market has discounted the best ahead, it has nowhere to go but down. And that's where Dow's Theory comes in. Dow indicated that the market, following a great, speculative bull movement, doesn't merely decline comfortably for a few months, it recedes to a point where it reflects economic hardship and mass pessimism—the other extreme of the cycle.

I should state that each bull market and its succeeding bear market constitute a complete cycle. Although the extent and duration of a primary bear market tends to be directly in proportion to the extent and duration of the preceding bull market, the new bull market (following the termination of a bear market) opens up an entirely new ball game. In other words, the new bull market may be great or sub-standard, no one can possibly know. But the new bull market has no relationship to the bear market which preceded it.

Now let's bring this discussion to the present. The current primary bear market (which began in 1966) followed the longest, the most speculative, the most manipulated, the greatest bull market in history. The bear market started from a bull market "top area" which in duration, speculative intensity, crowd excitement, and general euphoria, has no equal in Wall Street annals. I consider it entirely logical, therefore, that the primary bear market which followed (and which is in effect now) will be of massive proportions both in intensity, duration and extent. And just as the bull market constituted a milestone in American economic history, I expect this bear market to wind up as a phenomenon which will not soon be forgotten.

Now you can call the above statement "apocalyptic" or a "prophetic revelation" or anything else you wish. I call it an opinion based on history, current analysis and logic. I have tried to show how this bear market is working, how it moved through its first phase in 1966, how the 1966-68 upward correction drew in thousands of buyers while informed interests distributed, how the second phase got under way during late-1968 and why the second phase of the bear market is still continuing. I wrote about the high-degree of optimism which persisted all through the 1969-70 decline, how volume (which is a measure of public enthusiasm) consistently expanded on the upside and contracted on the downside, even though the '69-70 decline was of calamitous proportions.

Ultimately, I believe this second phase of the bear market is going to take the Dow Industrials well below the 631 level and at that time I expect that volume will change character, tending to expand on price declines and contract on rallies. This will be the first sign of selling urgency and the real beginning of mass pessimism.

Following the termination of the second phase, we should have another upside correction and then the final extended third phase, a low-volume persistent erosion in values which could take the Averages and most stocks to levels which would seem totally "impossible" today. At any rate, that is the big picture as I see it for the next few years. The daily, weekly and monthly fluctuations, rallies and jiggles may occupy the attention of 90% of Wall Street, but it is the big picture which will make or break the investor. Study the page 1 chart of the Averages. Remember how, at the time, you were caught up with the significance of every rally and decline? What do they all add up to now? The only important factors now are whether the Averages hold above their bear market lows or whether they work higher from here. And if the lows are broken, within a few months the entire rally from the May 26, 1970 lows will be entirely forgotten.

To my mind, the minor (daily) and secondary movements are mainly of interest in that they tend to confirm or raise doubts about the overall direction of the primary trend. During a bull market, the primary trend will eventually "bail" almost everyone out of their mistakes. This is because almost all stocks tend to climb higher (although at different times) within the framework of a primary bull trend. The opposite holds true during a primary bear market. During a bear market almost all purchases and holdings will ultimately become losses, since time deteriorates values in a bear market. During the successive major bear swings, almost all stocks will go down in unison (unlike a bull swing), and it is not unheard of for a single, great bear swing to literally cut the market value by a third to a half.

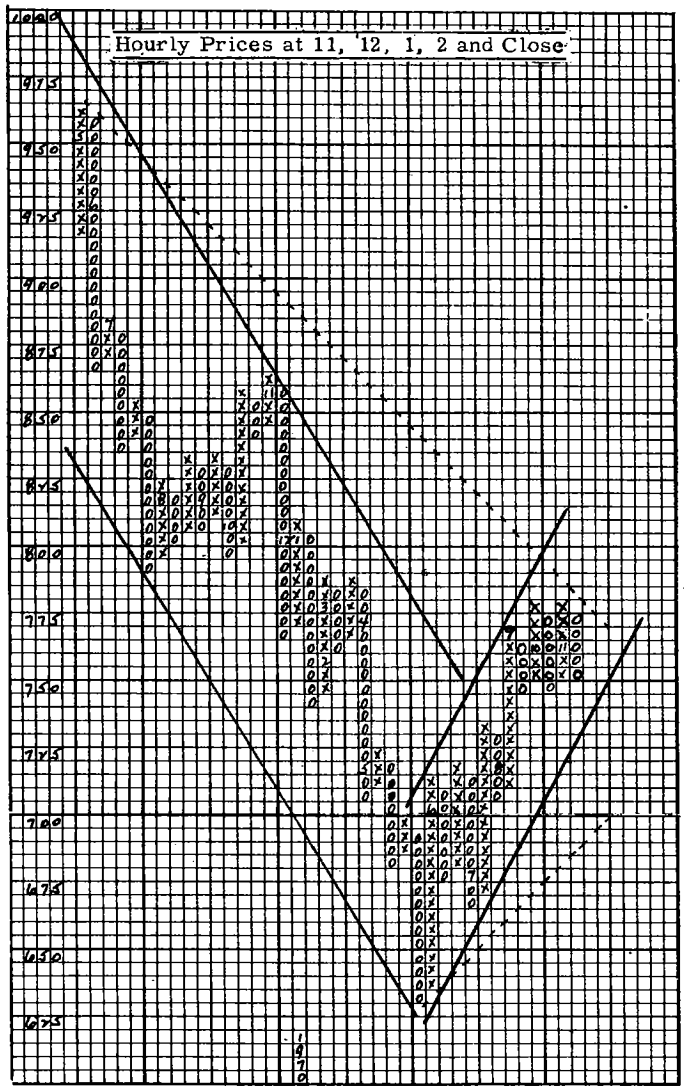
To turn to the near-term price picture, note on the page 1 chart that the October lows for the Averages were 753.56 on Industrials and 145.72 on Transportation. Following the November 11 peak, the market started down again, and on November 18 the Transportation Average penetrated its October low of 145.72. So far Industrials have not confirmed this weakness by penetrating their own October low of 753.56.

If the 753.56 level is broken, we can watch the September Industrial low of 747.47, a level which marks the bottom of the entire August-November range. If Industrials violate 747.47 with Transports declining "in gear", I would say that the market is moving into troubled waters. Finally, we have the 30-week moving average of the Dow at 740, and a breaking of 740 would further heighten the seriousness of the situation.

On the upside, it would require a joint bettering of the October peaks of 783.68 (Industrials) and 161.15 (Transports) to give the signal for an extension of the current upward correction. Industrials have already attempted on three occasions to push into the 785 area, and each time they have failed. At present they have the impetus of an almost hysterical fear of all-out inflation to help them, along with a collapse in business loans and one of the sharpest drops in interest rates and the most violent rallies in bonds in recent years.

It is suddenly dawning on the nation that the Administration has not only cynically abandoned the fight against inflation, but they are absolutely committing themselves to anything and everything which will serve to boom the economy— and this includes galloping inflation. Thus we see the incredible spectacle of Treasury Secretary Kennedy stating in public that he would not be disturbed by a $15 billion deficit and, in fact, "it might be helpful" in stimulating a slack economy. In the face of this sort of thing, the stock market, over the short term, can be expected to do absolutely anything.

I am including a point & figure chart at this time, showing the path of the Dow from May, 1969 to the present. The chart is a 5-point, 15-point reversal chart meaning that each box equals 5 points on the Dow, and only rallies or declines of a full 15 points or more are depicted. The X's on the chart denote rallies, the O's indicate declines. (P & F chart courtesy of Chartcraft, Larchmont, N.Y.).



The large, descending channel which I have drawn on the chart (solid black trendline) contained the Dow on its precipitous descent to the May 26 low of 631.16 (May low shown by the lowest O on the chart). From there I have drawn a narrower, ascending channel with a double top (the two X's) in the 780 level. Note that there is also a double bottom (the two 0's) at the 750 level.

In order the provide a bullish P & F reading, the Dow would have to rise above the double top — to 785. To provide a bearish reading, the Dow would have to drop below the two 0's at the 750 level — to 745. On a P & F basis, I would take a 745 Dow reading as step 1 of a bearish prediction. I would take a breaking of the lower channel line (which would require a Dow reading of 725) as step 2 of a bearish series. From there, I would take a penetration below the May 26 low (or a reading of Dow 630) to constitute step 3, and step 3, if completed, would also mean a reconfirmation of the primary bear trend.

EDGE OF THE STORM: While the U.S. was passing out 30% and 40% wage boosts, raising prices on item after item, and lowering interest rates, the dollar was again running into serious trouble. On November 24 it was announced that the Deutsche Bundesbank was forced to purchase almost $300 million to support the dollar, which was on the 3.6300 mark floor price. Since November 17 it is said that the Bundesbank has purchased almost $1 billion.

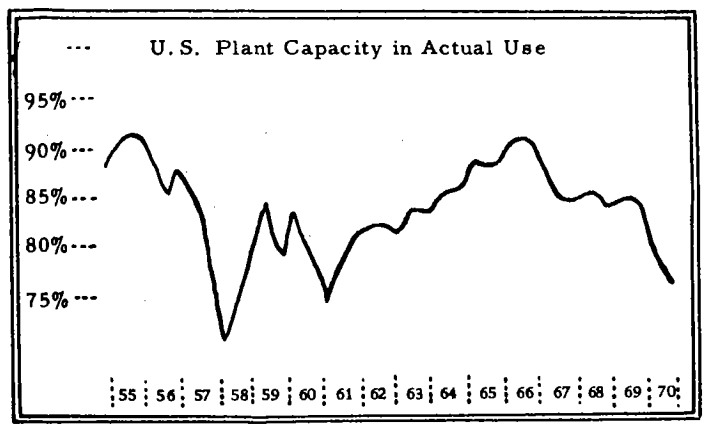
With this kind of build-up in dollars, it is obvious that the U.S. gold supply will shortly come under attack. Germany can hardly be expected to drown under an ocean of dollars purchased for support. Perhaps in anticipation of this, Rep. Harry Reuss (considered to be an expert on international monetary affairs) announced that the U.S. would embargo Treasury gold rather than raise the price above $35 per ounce.

Meanwhile, the European community is rapidly moving towards a currency of its own which my friend Harry Schultz claims will be called something on the order of the "Euro-Florin". This currency will be the vehicle which will cut Europe lose from the dollar. The currency will be gold-backed, and Europeans will probably agree to trade gold among themselves at a higher price — Alden Wells suggests around $50 per ounce.

When this occurs, I believe the repercussions for the U.S. will be momentous. The dollar, largely unbacked by gold, will then be competing with a stronger, gold-backed currency. World history indicates that the power of a nation rises and falls with the power and desirability of its currency. Time is running out for the dollar; it's reputation drops lower in world esteem with each passing year. Politics, greed, the defense-economy and towering deficits have ruled the U.S. scene for a quarter of a century. World markets are ruled only by truth and realism. The markets of the world are bigger than any government, treasury, legislative body or man-made laws. And the tides of the markets have ground even the mightiest governments under.

The Nixon Administration faces a great challenge between now and 1972. Expediency will not solve that challenge. If the Nixon Administration chooses the inflation path to solve its 1972 election problems, I predict nothing but trouble ahead. Inflation is the essence of economic immorality, it is legal stealing in the truest sense of the word. In the face of immorality, a nation's leaders must ultimately stand and fight. If Mr. Nixon chooses to do otherwise, he will reap the whirlwind.

CHART OF THE WEEK: One of the major forces behind the great bull movements of 1949 to 1966 was the successive booms in capital goods together with plant building and expansion. Of course, plant expansion is almost always associated with expectations of expanded needs during the year, two years or three years ahead.



One of the extraordinary phenomenons of the present is the steady decline in U.S. plant capacity in actual use, and this trend is documented on the accompanying chart. If the current trend towards sub-standard plant capacity continues, it will mean that there will be little capital expenditures in the period ahead. Furthermore, with corporate liquidity still at shockingly low levels, with the consumer reluctant to buy, with long-term interest rates still at extremely high levels, corporations will have little incentive to go out and build new capacity.

Additional capacity is often a good bet when building costs are low (they are unbelievably high now), but when consumers are playing it close to the vest, when building costs and money are dear, and when corporations are not using a quarter of their capacity, no capital boom is in sight.

Currently, we have a bearish outlook for consumer spending, building, capital spending and defense spending. The outlook for corporate earnings is also bearish. These factors should go together in producing the next major sweep of the bear market.

NOTE: I am taking the liberty of making this a four-page Letter, partly because of the Thanksgiving Holiday which means that this Letter will have to be completed and printed on Wednesday, November 25 (the day before Thanksgiving) and mailed on November 27 (Friday, the day after Thanksgiving). The problem, of course, is that my mailers eat turkey on Thanksgiving and don't do any mailing that day (for which they can be forgiven).

Incidentally, here is something which I thought was interesting. The New York Times Sunday Magazine presented a rather cynical article on investment services a few weeks ago (actually, I feel their cynicism is warranted). They estimated that half a million people buy one or more services, which means that only one in forty stockholders (of which there are 20 million) reads an investment service.

There are only about 3,000 investment advisors registered with the S.E.C. (an incredibly small number, to my mind) of which perhaps 1,000 put out reports of one kind or another (not necessarily on the stock market itself). Investors Intelligence polls the bullishness or bearishness of 60 of these services, and I would estimate that there are only about 50 or 60 services that have any real market influence. Medical Economics magazine lists (in a coming issue) the leading services read by doctors, and I think this service runs about seventh. Dow Theory Letters is listed in this article (along with one other) as one of the only two services to be accurate about the timing and intensity of the bear market. The record of the others is rather dismal.